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Message Text

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INFO OCT-01 EUR-25 ISO-00 SPC-03 SAM-01 AID-20 NSC-10

RSC-01 CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02

CIAE-00 COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12

LAB-06 SIL-01 DODE-00 PA-04 USIA-15 PRS-01 DRC-01

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R 082024Z FEB 74
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 7854

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DEPARTMENT ALSO PASS FRB AND TREASURY FOR F.L. WIDMAN

E.O. 11652:N/A
TAGS: EFIN, UK
SUBJECT: BANK OF ENGLAND LIKELY TO TIGHTEN UP ON FRINGE FINANCIAL INSTITUTIONS

BEGIN UNCLASSIFIED: SUMMARY. SINCE LAST NOVEMBER, THERE HAVE BEEN A SERIES OF RESCUE OPERATIONS OF FRINGE BANKING INSTITUTIONS IN THE U.K. THE DISCOUNT OFFICE OF THE BANK OF ENGLAND HAS SPEARHEADED THE RESCUE AND SUPPORT OPERATIONS. THE INSTITUTIONS BEING HELPED GENERALLY FALL OUTSIDE THE ROUTINE SCOPE OF SUPERVISION OF THE BANK OF ENGLAND, COMING UNDER THE SUPERVISION OF THE DEPARTMENT OF TRADE AND INDUSTRY. GOVERNOR OF THE BANK OF ENGLAND GORDON RICHARDSON INDICATED IN A SPEECH ON FEBRUARY 5 THAT THE BANK OF ENGLAND WILL PROBABLY BE TAKING STEPS TO BRING THESE INSTITUTIONS MORE CLOSELY UNDER ITS CONTROL. END SUMMARY.

1. AS A RESULT OF A LEGAL DECISION IN 1966, CERTAIN FIN-
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ANCIAL INSTITUTIONS, INITIALLY INSTALMENT CREDIT LENDERS,

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WERE EXEMPTED FROM SECTION 123 OF THE 1967 COMPANIES ACT. THIS AVOIDED THEIR BEING DEEMED UNLICENSED MONEY LENDERS, WHICH ARE NOT ENTITLED TO LEGALLY RECOVER PROCEEDS OF THEIR LOANS. FINANCIAL INSTITUTIONS IN THIS SECTION 123 EXEMPTION STATUS COVER WIDE AND MOTLEY ASSORTMENT INCLUDING MAJOR AND MINOR FINANCE HOUSES AND INSTITUTIONS THAT LEND FOR CONSUMER AND SHORT-TERM INDUSTRIAL PURPOSES, AND PERHAPS SOME INVESTMENT BANKING AND EQUITY OPERATIONS. SOME OF THESE SECTION 123 COMPANIES ARE LARGE, RESPECTABLE AND FINANCIALLY SOUND. OTHERS ARE LESS SO. INITIALLY, THEY DISPLAYED VERY FEW REAL BANKING CHARACTERISTICS, BUT FROM 1966 THEY FELT OBLIGED TO BUILD UP THEIR DEPOSIT TAKING AVAILABILITY IN ORDER TO CONVINCE THE BOARD OF TRADE (LATER DEPARTMENT OF TRADE AND INDUSTRY) THAT THEY WERE ENTITLED TO A SECTION 123 EXEMPTION STATUS. OVER TIME, THE SYSTEM BECAME COMPLICATED AND NOT EASILY COMPREHENSIBLE TO THE PUBLIC ESPECIALLY IN CONTEXT WHERE OPERATING CERTIFICATES WERE GIVEN TO FINANCIAL INSTITUTIONS WHICH ARE NOT CONSIDERED BANKS BY THE BANK OF ENGLAND, BUT, WHICH NONETHELESS QUALIFIED FOR OR COULD BE REGARDED FOR THE PURPOSES OF U.K. MONEY LENDING LEGISLATION AS CARRYING ON A BANKING BUSINESS, ALBEIT LIMITED IN EXTENT.

2. SINCE NOVEMBER, A SERIES OF THESE FRINGE BANKING INSTITUTIONS INCLUDING NAMES SUCH AS LONDON AND COUNTY, CEDAR HOLDINGS AND MOORGATE MERCANTILE RAN INTO DIFFICULTY STEMMING FROM DECLINE IN THE VALUE OF THEIR BALANCE SHEET ASSETS (INCLUDING SECURITIES AND PROPERTY VALUES) TIGHTENING CREDIT CONDITIONS GENERALLY, INSUFFICIENT LIQUIDITY AND POOR MANAGEMENT CONTROL, AS WELL AS SOME ALLEGATIONS OF LENDING TO AFFILIATES CONNECTED WITH DIRECTORS OF THESE FRINGE INSTITUTIONS.

3. MANY OF THESE FRINGE INSTITUTIONS HAD TAKEN SHORT-TERM DEPOSITS FROM LARGE MONEY MARKET OPERATORS, WHO QUICKLY RESPONDED TO EVIDENT WEAKNESS IN SOME FRINGE

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LAB-06 SIL-01 DODE-00 PA-04 USIA-15 PRS-01 DRC-01

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INSTITUTIONS BY WITHDRAWING FUNDS FROM A WIDE RANGE OF THESE SECONDARY BANKING COMPANIES. IN PART TO PROTECT SMALL DEPOSITORS, THE BANK OF ENGLAND MOVED IN AND WITH THE LONDON AND SCOTTISH CLEARING BANKS ESTABLISHED MACHINERY TO MONITOR THE SITUATION AND WHERE APPROPRIATE PROVIDED FINANCIAL SUPPORT TO REPLACE THE MONEY MARKET FUNDS WHICH HAD BEEN WITHDRAWN. IN THE U.K., DEPOSITORS ACCOUNTS ARE NOT INSURED BY THE GOVERNMENT NOR ARE THERE FORMAL BANK EXAMINATIONS SUCH AS IN THE U.S. SITUATION NOW APPEARS TO HAVE STABILIZED ALTHOUGH THERE WERE SOME TENSE MOMENTS AS THE RESCUE OPERATION WAS PUT TOGETHER. AT ONE POINT, ONE OF U.K. FRINGE INSTITUTIONS IN DIFFICULTY (CEDAR HOLDINGS) WAS ATTEMPTING TO PURCHASE A U.S. BANK. TO EMBASSY'S KNOWLEDGE, NO U.S. FINANCIAL INSTITUTIONS OPERATING IN U.K. HAVE BEEN INVOLVED IN THIS EXERCISE, NOR HAS ANY OF THE ADVERSE PUBLICITY RESULTING BEEN AIMED AT U.S. BANKS OPERATIONS IN THE U.K. ON THE CONTRARY, FEBRUARY 9 ECONOMIST SUGGESTS ADOPTION BY U.K. OF AMERICAN SYSTEM OF INSURANCE FOR SMALL DEPOSITORS.

4. IN A SPEECH GIVEN TO THE INSTITUTE OF BANKERS ON
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FEBRUARY 5, GORDON RICHARDSON, GOVERNOR OF THE BANK OF ENGLAND, SUGGESTED THREE LESSONS HAVE BEEN LEARNED. FIRST IS THAT THE SECONDARY BANKS THEMSELVES NEED MORE EXPERIENCED MANAGEMENT AND ADVISORS, IMPROVED STANDARDS AND DISCIPLINE AND MORE RELIABLE AND STABLE SOURCES OF FINANCE. SECONDLY, ROLE OF LARGE DEPOSITORS IN WHOLESALE MONEY MARKETS NEEDS REVIEW. LARGE SUMS APPARENTLY PLACED AT THE OFFER OF HIGHER RATES OF INTEREST THAN AVAILABLE FROM THE CLEARING BANKS WITHOUT SUFFICIENT PRUDENCE. DEPOSITS WERE WITHDRAWN VERY QUICKLY AT FIRST

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SIGN OR RUMOR OF DIFFICULTY. RICHARDSON SAID GREATER INITIAL DISCRIMINATION, MORE THOROUGH ASSESSMENT OF COMPANY WITH WHICH MONEY PLACED SEEMS NECESSARY. THIRDLY, SELF REGULATION AND SELF DISCIPLINE WHICH ARE VERY IMPORTANT IN U.K. SYSTEM CAN PERHAPS BE PUT TO TOO GREAT A TEST IF COMPETITION FROM THE LESS REGULATED AND LESS DISCIPLINED IS TOO EASILY PERMITTED. THIS RAISES QUESTION OF DEGREE OF PRUDENT REGULATION AND SUPERVISION WHICH THE AUTHORITIES SHOULD EXERCISE OVER DEPOSIT TAKING INSTITUTIONS. RICHARDSON DREW CONCLUSION THAT BANK OF ENGLAND SURVEILLANCE AND CONTROL WILL NEED TO BE EXTENDED BEYOND THEIR PREVIOUS RANGE. IT MAY ALSO BE NECESSARY TO TIGHTEN UP ON LAWS REGARDING THE USE OF WORDS LIKE "BANK" AND "BANKERS" IN DESCRIPTIVE AND ADVERTISING MATERIAL.

5. LOOKING AHEAD, RICHARDSON SAID SOME MORE FORMAL FRAMEWORK MAY BE REQUIRED AS HARMONIZATION OF PRACTICE RELATING TO ESTABLISHMENT AND SUPERVISION OF DEPOSIT TAKING INSTITUTIONS IS PROGRESSIVELY ACHIEVED WITHIN THE EEC. THIS HOWEVER, SHOULD BE APPROACHED WITH CARE AND WITH DUE CONSIDERATION AND AFTER DEBATE WITH THE BANKING INDUSTRY ITSELF. END UNCLASSIFIED

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6. COMMENT: RESPONSIBLE (I.E., ESTABLISHMENT) BANKING COMMUNITY AND FINANCIAL PRESS VIEW THIS PUBLIC EXPRESSION OF INTEREST IN THE SITUATION BY GOVERNOR OF THE BANK OF ENGLAND AS OVERDUE. THEY HOPE IT SIGNALS A SHIFT IN RESPONSIBILITY AND CONTROL OF THESE INSTITUTIONS FROM THE DEPARTMENT OF TRADE AND INDUSTRY TO THE BANK OF ENGLAND. MAJOR CLEARING BANKS ARE THEMSELVES SOMEWHAT ANNOYED TO
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HAVE BEEN HERDED INTO A RESCUE OPERATION OF LESS RELIABLE

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COMPETITORS AT A TIME WHEN THEIR OWN OPERATIONS AND LENDING TO THEIR CLIENTS HAVE BEEN CURTAILED BY THE CURRENT CREDIT SQUEEZE. NONETHELESS, RESCUE OPERATION WAS CONSIDERED NECESSARY IN ORDER TO MAINTAIN REPUTATION AND FAITH IN STABILITY OVERALL U.K. FINANCIAL COMMUNITY.

7. FULL EXTENT OF THE RESCUE OPERATION MAY NEVER BE KNOWN PUBLICLY. BANK OF ENGLAND, AT LEAST OFFICIALLY, IS NOT TALKING. FACT THAT GOVERNOR OF BANK OF ENGLAND PUBLICLY RAISED ISSUE VIEWED IN FINANCIAL CIRCLES AS INDICATION THAT MATTER IS UNDER CONTROL. ECONOMIST FEBRUARY 9 SAYS CLEARING BANKS PUT UP OVER 500 MILLION POUNDS IN RESCUE OPERATIONS. OUR CONTACTS, WHO SHOULD KNOW, SAY THIS IS AN EXAGGERATION. OF ABOUT 120 FRINGE BANKING OPERATIONS, PERHAPS AS MANY AS 20 MAY HAVE BEEN UNDER SURVEILLANCE OR IN QUESTION. OF THESE, SOME WERE TO QUOTE ONE INFORMED SOURCE, ALL RIGHT, BUT WORRIED. OTHERS WERE IN TROUBLE, AND ARE STILL BEING HELPED. INFORMATION IN THIS PARAGRAPH CONSIDERED DELICATE AND CONFIDENTIAL BY OUR SOURCES. PLEASE TREAT IT AS SUCH.
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